BANK VALUE IN THE FRAMEWORK OF THE CONCEPT OF SUSTAINABLE DEVELOPMENT

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Abstract

The concept of company's value is in the focus of modern business literature. However, the interpretation of the notion differs widely depending on the research directions. The object of the given research is bank value. The scientific goals of the current survey are (1) to verify the validity of the authors' developed structural model of the concept of bank value, and (2) to study the concept of bank value within the framework of the concept of sustainable development. The validation of the developed model was made through the discussion with the experts in the field. The analysis of relevant scientific literature and banks' reports on corporate responsibility was made to understand the role of modern banking in relation to the public interests. The empirical results of the research are reflected in the advanced conceptual model of bank value.

Key words: concept of value, modern banking, sustainable development.

Introduction

Banks are the most important category of financial institutions in the new Member States (NMS) of the European Union, including Latvia. The role of insurance companies, investment funds and pension funds in NMS is still underdeveloped, comparing with other European Union countries [1]. Banks, as a core of the financial system, have a great influence on the national economy in a whole, and the performance of the banking sector is a big part of overall economic performance. In particular, the ability of banking sector to create value for bank shareholders has an impact on the volume of foreign investment, since the investors in shareholder-oriented economies will receive the higher return on capital, than in other countries [2].

Financial crisis has had the largest negative effect on banking sectors in Baltic States comparing with other NMS. Return on equity (ROE) index has gone down dramatically in Latvia and in its closed neighbors [3]. Thus, value creation in Latvian commercial banks is a top problem on the agenda.

However, the process of looking for ways to maximize value should be started with clarifying the term "bank value" and determining its key components.

The object of the current research is the concept of bank value within the framework of the concept of sustainable development.

The paper reflects the findings of the earlier authors' conducted research, the results of the practical survey, and the findings of literature dedicated to sustainability issues in banking.

The qualitative analysis of the terms *Bank* and *Company's Value,* using the program AQUAD was made while conducting the previous research. AQUAD, in summary, is a program for the generation of theory on the basis of qualitative data. AQUAD supports some versions of conventional content analysis. The special characteristic of AQUAD is its ability not only to categorize and then to assemble the data for each category, but to allow the researcher drawing conclusions by relating categories to each other, i.e., by exploring the occurrence of typical and repeated configurations of category representations in the data [4]. The empirical results allowed constructing the structural model of the concept of Bank Value.

The scientific goals of the current research are determined, as follows:

1. To verify the validity of the developed structural model of the concept of bank value;
2. To study the concept of bank value within the framework of the concept of sustainable development.

The validation of the developed model was made through the discussion with the experts in the field. The academic staff with finance-related specialization from European universities was surveyed, using the mail questionnaire method.

To find the linkages between the concepts of bank value and sustainable development and the possibilities to merge them into one integral model the authors analyzed the banking industry's approach to sustainable development. The analysis of relevant scientific literature was made to understand the role of modern banking in relation to the public interests.

Our hypothesis is determined, as follows:

Modern concept of Bank Value should involve the components of the concept of Sustainable development.

The paper offers the advanced conceptual model of bank value. The model combines the ideas proponed by relationship value management, shareholder and stakeholder models, and concept of sustainable development.

1. Banking business and sustainable development

From the traditional point of view banks are engaged in two processes: 1) deposit attraction, and 2) lending, i.e., they play intermediary role between lenders and borrowers [5].

The process of intermediation requires that something be created by the transformation of inputs into outputs. The appropriate term for the product created by banks is liquidity, which relies in turn on four processes: *maturity transformation*, *risk reduction*, the *reduction of search and transaction costs* and *monitoring* (dealing with asymmetric information) [6].

The changes in a global economic environment stimulated the traditional banking functions became more sophisticated. The processes of globalization and IT development have changed the face of banking. In response to new challenges, banks were forced to extend business areas. Nowadays, banks are not only intermediaries between lenders and borrowers, but also are risk managers with superior information and knowledge management capabilities.

In any case, whatever function bank performs, its primary goal is to maximize shareholder value [7].

Although the concept of shareholder value is often criticized by the proponents of stakeholder theory [8], the fact is "that the more shareholder value a company creates in an effectively regulated market, the better the company serves all its stakeholders" [9].

According to the stakeholder theory [10], stakeholder groups include: customers, employees, suppliers, community, governments, and environment. Considering that stakeholder is "any group or individual who can affect or is affected by the achievement of an organization's objectives" [11], it is necessary to mark out managers (top executives and middle managers) of a bank as a separate stakeholder category.

Studying the concept of bank value, our prime interest is related to the factors affecting its creation, i.e., value drivers. These factors can be grouped according to the different criteria. For instance, the value can be created by different groups of individuals who have an impact on a bank performance (stakeholder theory), or using critical success factors (balanced scorecard approach). Value drivers can be classified as financial and non-financial, tangible and intangible, etc.

Based on Kaplan&Norton [12], intangible assets amount to about 75 percents of company's value. The creators of the BSC argue that in the information age, organizations require new capabilities for competitive success, such as customer relationships, product innovation, customized products, employee skills, motivation, and information technology.

Besides, bank reputation should be considered as a factor with a high impact on bank performance. Success of any company, including financial institutions, is influenced by its customers who all are human beings. And, all humans without exception are subject to the influencing power of imagery. Poor reputation or negative imagery results in reduced consumer confidence, and a subsequent decline in brand value. *Image* and *reputation* are interpretations, controlled by public perceptions and general beliefs [13].

Nowadays, public interests are focused on social and environmental issues. Banks are also affected by society's changing preferences and changing worldviews. This is the inducement for many banks to implement sustainable strategy.

For instance, ABN AMRO affirms in its Sustainability review: "we believe we must take our responsibility seriously to play a constructive role in issues affecting the world around us" [14].

Corporate Sustainability is a business approach to create long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. Today, a growing number of investors perceives sustainability as a crucial success factor. As a result, investors are increasingly diversifying their portfolios by investing in companies that set industry-wide best practices with regard to sustainability [15].

As it was mentioned above, the modern banking business is significantly influenced by the process of globalization. The impact is expressed, mainly, in financial market liberalization that, in turn, causes an increased competition. The competitive power of a bank is largely defined by the degree of its conformance to customer needs. When investors and businesses want to invest in or develop towards sustainable development, banks will strive to develop products that meet their requirements.

Besides, banks should offer their customers something new to survive in a competitive struggle. Sustainable development provides opportunities for banks in the form of offering new products to customers, like eco-credit cards and green and environmental technology funds as well as environmental insurance. Opportunities also exist in new markets such as water treatment technology or wind energy. Whether a bank can take advantage of the opportunities for new products and new financing markets depends on its level of knowledge, experience and creativity.

Another argument for sustainability is that banks have a financial motivation to integrate sustainable development principles into business. For instance, according to the 2001 sustainability report of Co-operative bank, the bank's ethical and ecological positioning has made a direct contribution of about 20 percent to the company's profitability [16].

As a final argument we can mention possible consumers' action against companies, which act irresponsibly in the eyes of the public. The good example of this was a boycott of Shell company in 1995 [17].

Thus, all banks will eventually integrate sustainable development principles in their activities under the pressure of their stakeholders or stimulated by internal reasons. Banks can join one of two camps:

- Developing bank's strategy and organizing business according to sustainability principles. This includes everything from setting ethical standards for investing, to designing products with sustainability features at their core.
- Tweaking existing business and operations to incorporate sustainability and social responsibility. This might include recycling and energy efficiency measures, building green features into existing products, supporting the global environmental initiatives etc.

2. Conceptual model of Bank Value: Implementation of sustainability principles

As it was mentioned in the introduction, our previous research was dedicated to distillation of elements of the concept of Bank Value [18].

Using the specialized software, we examined separately the concept of bank and the concept of value. Analyzing the notion of bank, we analyzed bank definitions, text segments describing the functions of financial system, and text segments describing banking activities. For a total, the 29 text segments related to the term "bank" and 31 text segments related to the notion of value of a company were analyzed.

The results of the research were reflected in our developed Model of the concept of Bank Value (Fig. 1).

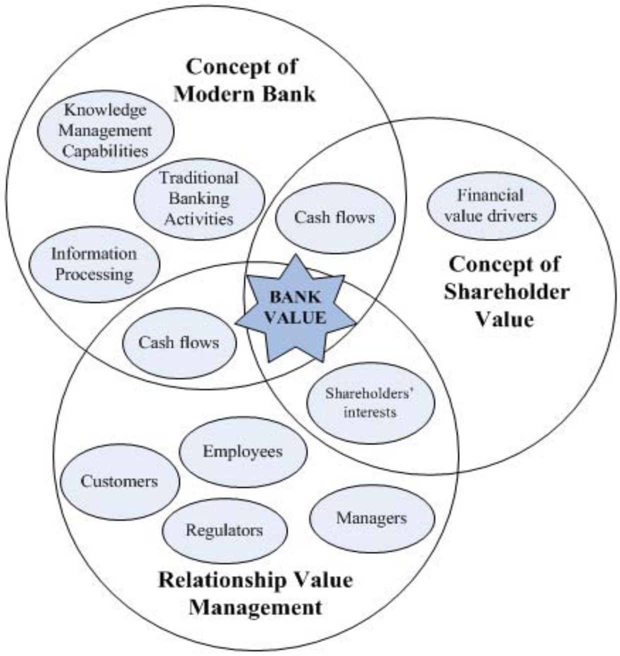

Fig 1. Structural Model of the Concept of Bank Value

The validity of the model was checked, using mail questionnaire method. The group of respondents comprised of experts from Dokuz Eylul Universitesi (Turkey), Mykolas Romeris University (Lithuania), Leeds Metropolitan University (U.K.), Vilnius Gediminas Technical University (Lithuania), Riga Technical University (Latvia), Tallinn University of Technology (Estonia), Prague University of Economics (Czech Republic), University of Gdansk, Wroclaw University of Economics (Poland).

The results of the survey confirm the importance of the ideas provided by the proponents of shareholder theory in relation to the concept of Bank Value. Shareholders were evaluated as the most important stockholder group for a bank (73% of respondents). However, the role of other stakeholders was underestimated. For instance, nobody of respondents gave the highest priority to the employees and managers. Society, as a whole, was evaluated as a stakeholder group with average importance for a bank with average mark 3 points at 1-to-5 scale.

In turn, the world's most successful banks assert that competitive advantage is based on intangible assets, i.e., understanding stakeholder behavior, identifying ways to serve stakeholders better, and building enduring partnerships with stakeholders [19].

Considering the results of our previous research [18], taking into account the importance of reputational management and such integral part of business strategy as corporate social responsibility, the authors present the advanced model of the concept of bank value (see Fig 2).

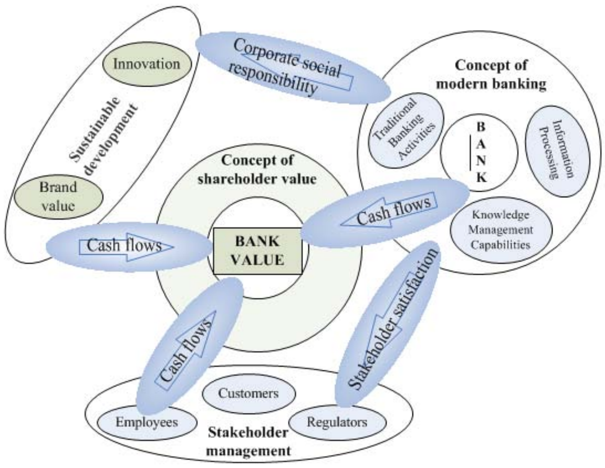

Fig 2. Advanced model of the Concept of Bank Value

Thus, we associate business value mainly with shareholder value instead of company's market value etc.

Within the framework of the concept of modern banking the traditional intermediary role of banks was supplemented by the role of information processors, risk managers and innovation stimulators.

A successful stakeholder management approach focuses on delivering satisfaction to all of the stakeholder groups. Community is not distilled as a separate stakeholder group, because, on our opinion, community consists of existing and potential bank customers.

Implementing the principles of sustainable development will raise bank's reputation. Besides, the opportunities to capture new markets arise.

Conclusions

Sustainable development becomes an important strategic dimension for banks. Society's quest for sustainable development involves the creation of new financing markets. Banks can step into this growing market or develop specific products such as environmental loans.

Growing significance of a customer-oriented approach and declining customer loyalty emphasizes the importance of improving competitiveness through differentiation. Bank's ecological positioning can make a direct contribution to the profitability [16].

Reputation is a crucially important aspect of bank management. Nowadays, public interests are focused on social and environmental issues. Thus, all banks will eventually integrate sustainable development principles in their activities under the pressure of their stakeholders or stimulated by internal reasons.

Commitment to sustainable development means to pay attention to all of a company's stakeholders. However, bank executives should remember that the highest goal of any company is maximization of shareholder value. A company with high environmental and social standards but low shareholder value will eventually be driven out of business.

The authors' developed model of the concept of bank value, combining the ideas proponed by the concept of shareholder value, stakeholder management and sustainable development.

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